Supreme Court, U.S.
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No. 98-

IN THE SUPREME COURT OF THE UNITED STATES OCTOBER TERM, 1998

ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

SUPPLEMENTAL APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI

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UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

DOCTOR'S ASSOCIATES, INC., Plaintiff,	:	
-vs-	:	Civil No. 3:97cv00459
ERIK J. HAMILTON, Defendant.	:	(PCD)

RULING ON PETITION TO COMPEL ARBITRATION AND MOTION FOR INJUNCTIVE RELIEF

Plaintiff Doctor's Associates, Inc. ("DAI") moves to compel arbitration of its dispute with Defendant Erik J. Hamilton ("Defendant") pursuant to 9 U.S.C. § 4 and for an injunction enjoining Defendant from prosecuting the action currently pending in the New Jersey state court. For the following reasons, DAI's petition to compel arbitration is DENIED. DAI's motion for an injunction is DENIED.

I. BACKGROUND

DAI is the national franchisor of Subway sandwich shops and is a Florida corporation. Defendant is a Subway franchisee residing in New Jersey. On or about June 27, 1995, DAI entered into a standard written franchise agreement with Defendant, permitting him to operate a Subway shop in New Jersey. The agreement contains an arbitration clause (¶ 10c), which provides:

> Any dispute or claim arising out of or relating to the Agreement not settled by the parties . . . in accordance with the

terms of this Agreement is to be submitted directly to arbitration, shall be settled in accordance with the Expedited procedures of the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held at Bridgeport, Connecticut. Judgment upon an award rendered by the Arbitrator may be entered in any court having jurisdiction. The commencement of . . . arbitration proceedings by an aggrieved party to settle any such dispute or claim is a condition precedent to the commencement of legal action by either party, except as specifically provided in the Agreement.[1]

Paragraph 10(b) of the agreement provides:

The parties hereby agree that the Federal Arbitration Act shall apply to all disputes and claims arising out of or relating to the Agreement, including the breach thereof, and including any alleged violations of the Racketeering Influenced and Corrupt Organizations Act (RICO), applicable state franchise disclosure or franchise relationship statutes, including but not limited to unfair trade practice statutes or similar

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[1] Defendant does not dispute that his state court claims fall within the scope of the arbitration clause.

> statutes, and that the business which is the subject of this Agreement is engaged in interstate commerce.

Disputes arose and DAI filed a demand for arbitration with the American Arbitration Association ("AAA") on or about January 8, 1997. DAI requested declaratory judgment that it did not fraudulently induce Defendant to enter into the franchise agreement and that "any failure of Defendant's business and loss of money was entirely the responsibility of [Defendant]." Arbitration Demand. On or about January 22, 1997, Defendant filed a lawsuit against DAI and certain DAI employees in the Superior Court of New Jersey, County of Middlesex, Case No. L-847-97. Defendant alleges in his state court complaint that he was fraudulently induced to enter into the franchise agreement and that certain actions taken by DAI under the franchise agreement violate the New Jersey franchise protection statute.[2] DAI seeks to compel arbitration of that dispute and an order enjoining Defendant from prosecuting that action.

Defendant opposes DAI's petition alleging that: (1) there is not subject matter jurisdiction; (2) the clause requiring arbitration in Connecticut is void and unenforceable under the law of New Jersey (the law Defendant claims applies) or Florida (the law

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[2] DAI did not demand arbitration of Defendant's claim that DAI violated the New Jersey franchise act, presumably because DAI filed its demand before Defendant filed his complaint, and therefore DAI was unaware of the claim.

chosen in the franchise agreement); (3) the choice of law clause designating Florida law is void and unenforceable as against public policy because it conflicts with the New Jersey franchise act; and (4) the arbitration clause requiring the parties to share the costs of arbitration conducted in Connecticut is void and unenforceable as it is unconscionable and is a violation of Defendant's due process rights. The parties waived a hearing on this matter.

II. DISCUSSION

A. Subject Matter Jurisdiction

Pursuant to § 4 of the Federal Arbitration Act ("FAA"), district courts only have jurisdiction to hear petitions to compel arbitration if the court "would have jurisdiction under Title 28, in a civil action . . . of the subject matter of a suit arising out of the controversy between the parties . . . ." 9 U.S.C. § 4. Accordingly, "there must be diversity of citizenship or some other independent basis for federal jurisdiction before the [arbitration] order can issue." Doctor's Associates, Inc. v. Distajo, 66 F.3d 438, 444 (2d Cir. 1995), cert. denied, 116 S. Ct. 1352 (1996) (citation omitted). DAI alleges diversity jurisdiction. 28 U.S.C. § 1332. Defendant contests diversity jurisdiction on the basis that the amount in controversy does not exceed the sum or value of $75,000 because the franchise agreement sets a cap on the amount of damages recoverable from claims arising under or relating to the franchise agreement.[3]

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[3] Paragraph 10(d) of the franchise agreement provides:

DAI, having invoked federal jurisdiction, has the burden of proving the requisite amount in controversy. United Food Local 919 v. Centermark Properties, 30 F.3d 298, 301 (2d Cir. 1994); R.G. Barry Corp. v. Mushroom Makes, Inc., 612 F.2d 651, 655 (2d Cir. 1979).

"[D]iversity jurisdiction is determined by reference to the parties named in the proceeding before the district court." Distajo, 66 F.3d at 445. DAI's petition to compel arbitration states that the amount in controversy exceeds $75,000, and "'the sum claimed by the plaintiff [DAI] controls if the claim is apparently made in good faith. It must appear to a legal certainty that the claim is really less than the jurisdictional amount to justify a dismissal.'" A.F.A. Tours, Inc. v. Whitchurch, 937 F.2d 82, 87 (2d Cir. 1991) (quotation omitted) (emphasis in original).

"[T]he amount in controversy in a petition to compel arbitration . . . is determined by the underlying cause of action that would be arbitrated." Jumara v. State Farm Ins. Co., 55 F.3d 873, 877 (3rd Cir. 1995). The court should look at the "possible award resulting from the desired arbitration, since the petition to compel is only the first step in litigation which seeks as its goal a judgment

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The parties agree that the total of all permissible claims arising under or relating to this Agreement, including the breach thereof, for damages made by either party against the other shall not exceed $50,000, as adjusted for inflation annually . . . . [N]either party shall make a claim against the other for punitive or consequential damages nor seek multiple forms of damages of any kind with respect to any claim or cause of action.

affirming an award." Davenport v. Procter & Gamble MFG. Co., 241 F.2d 511, 514 (2d Cir. 1957). The amount in controversy is the difference "between winning and losing the underlying arbitration. . . ." Webb v. Investacorp, Inc., 89 F.2d 252, 257, n. 1 (5th Cir. 1996).

The underlying dispute to be arbitrated, as set forth in DAI's Demand for Arbitration, is whether DAI fraudulently induced Defendant to enter into the franchise agreement and whether Defendant's losses were the responsibility of Defendant or DAI. "[T]he amount in controversy, in an action for declaratory. . . relief, is the value of the right to be protected or the extent of the injury to be prevented." Webb, 89 F.3d at 256 (quotation omitted). Accord: Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333, 347 (1977) ("[i]n actions seeking declaratory or injunctive relief it is well established that the amount in controversy is measured by the value of the object of the litigation . . .").

Defendant seeks monetary damages in state court and that amount is the "injury to be prevented" in the arbitration. As such, Defendant's state court complaint provides a basis for ascertaining the amount in controversy in DAI's Petition to Compel Arbitration. Defendant seeks over $1,000,000 in damages in his state court action – well over the $75,000 minimum. Defendant has ignored the cap on damages set forth in the franchise agreement, and as a result, DAI is forced to defend a claim for over

$1,000,000.[4] If DAI wins in arbitration and successfully enjoins Defendant here it will have eliminated a damage exposure of over $1,000,000. The damages sought in the state action is the "injury to be prevented" in the arbitration – that is the amount in controversy. Defendant's assertion that either ¶ 10(d) is valid and there is no diversity jurisdiction or ¶ 10(d) is invalid and the entire agreement is unenforceable, is without merit.[5] There is subject matter jurisdiction over DAI's petition.

B. Forum Selection Clause

Defendant alleges that the "forum selection clause" requiring disputes to be arbitrated in Bridgeport, Connecticut is void and unenforceable as against the public policy of New Jersey. Defendant cites Kubis v. Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 680 A.2d 618 (N.J. 1996).

Assuming the New Jersey franchise act applies, Defendant's position is unpersuasive. In Kubis, the New Jersey Supreme Court held that a forum selection clause in a franchise agreement designating

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[4] DAI, in fact, has exercised its right not to enforce that provision of the agreement and so notified Defendant on April 22, 1997. Paragraph 11(c) provides that any portion of the agreement "shall be deemed not to be a part of this Agreement . . . upon the Franchisee's receipt of notice of nonenforcement from the Company."

[5] If this provision is found to be invalid, the remainder of the agreement remains in full force, including the arbitration clause. See Paragraph 11(c).

a judicial forum is presumptively invalid under the New Jersey franchise protection act. The court reasoned:

> [O]ur concern is not focused only on the likelihood that the court in the designated forum would properly interpret and apply the Franchise Act, but rather on the denial of a franchisee's right to obtain injunctive and other relief from a New Jersey court. The added expense, inconvenience, and unfamiliarity of litigating claims under the Act in a distant forum could, for some marginally financed franchisees, result in the abandonment of meritorious claims that could have been successfully litigated in a New Jersey court.

Kubis, 146 N.J. at 196, 680 A.2d at 627. Kubis is distinguishable from this case, having dealt with a forum selection clause designating a judicial forum – the question presented here is the validity of a forum selection clause designating an arbitral forum. Federal substantive law governs the enforceability of agreements to arbitrate, and the Supreme Court has resolved this issue against Defendant.

In Southland Corp. v. Keating, 465 U.S. 1 (1983), the Supreme Court reversed the California Supreme Court's holding that claims under the California Franchise Investment were not subject to arbitration pursuant to the parties arbitration agreement. In reversing, the Supreme Court held that the FAA preempted the California act: "In

enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." Id. at 10.[6] "In creating a substantive rule applicable in both state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 16.[7]

Defendant and DAI agreed to arbitrate all disputes arising under or relating to the franchise

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[6] The Supreme Court explained the distinction between general contract defenses:

We agree, of course, that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement. We conclude, however, that the defense to arbitration found in the California Franchise Investment Law is not a ground that exists in law or in equity "for the revocation of any contract" but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the California Franchise Investment Law.

Southland, 465 U.S. at 16 n. 11.

[7] See also Saturn Distribution Corp. v. Williams, 905 F.2d 719, 727 (4th Cir. 1990) (Virginia's dealer protection statute "is preempted by the Federal Arbitration Act to the extent that it interferes with the nonnegotiable arbitration provision" in the parties' agreement "requiring the exclusive use of binding arbitration for the determination of dealer contract disputes"); Sweet Dreams Unlimited v. Dial-A-Mattress Intern., 1 F.3d 639, 641 n. 3 (7th Cir. 1993) ("the Supreme Court has held that the Federal Arbitration Act supersedes any state provision that might attempt to insulate certain causes of action from arbitration") (citing Southland Corp. v. Keating, 465 U.S. 1, 10-16 (1984)).

agreement. Defendant may not rely on the New Jersey franchise law to invalidate the parties' arbitration agreement. Defendant is obligated to arbitrate the parties' disputes, including the allegations that DAI violated the New Jersey franchise act.

C. Choice of Law Provision

Defendant alleges that the franchise agreement's designation of Florida law as the law governing the parties relationship is void, unconscionable and unenforceable as against public policy because it conflicts with the New Jersey franchise law. The enforceability of the agreement's choice of law provision does not impact the validity of the arbitration agreement. See Doctor's Associates v. Distajo, 107 F.3d 126, 131 (2d Cir. 1997) ("even the inclusion of a choice-of-law clause does not require application of state law to arbitrability issues"); McCowan v. Sears, Roebuck & Co., 908 F.2d 1099, 1106 (2d Cir. 1990) ("[i]n enacting the Federal Arbitration Act, Congress created national substantive law governing all questions of the validity and enforceability of arbitration agreements within its scope"), cert. denied, 498 U.S. 897 (1990). Defendant is obligated to arbitrate his disputes with DAI regardless of the enforceability of that provision.

D. Unconscionability

Defendant also contends that the arbitration clause is unconscionable and unenforceable to the extent that clause requires Defendant to travel to Connecticut to pursue his New Jersey franchise act

claims and requires the parties to share the costs of the arbitration in Connecticut.[8] Defendant further contends that the financial obligations imposed upon him by arbitration before the AAA violate his right to due process. Defendant fails to cite any authority in support of his due process claim. In support of his unconscionability claim Defendant cites Cole v. Burns Intern. Security Services, 105 F.3d 1465 (D.C. Cir. 1997). The Second Circuit, however, has already addressed this issue. In Doctor's Associates v. Stuart, 85 F.3d 975 (2d Cir. 1996), the court of appeals rejected the claim that the charges involved with presenting disputes before the AAA and the high cost of the Illinois franchisees being forced to arbitrate in Connecticut render the arbitration clause unconscionable and void. Id. at 980-81. Accordingly, this defense is without merit.

E. Fraudulent Inducement

Although not raised in Defendant's opposition papers to DAI's petition to compel, Defendant's fraudulent inducement claims must be resolved initially by the court and is not subject to arbitration. Distajo, 66 F.3d at 457. "[I]f the 'arbitration clause was induced by fraud, there can be no arbitration; and if the party charging this fraud shows there is substance to his charge there must be a judicial trial of that question before a stay can issue.'" Id. (quotation omitted) (emphasis in original). Accordingly, DAI is not entitled to compel arbitration

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[8] Paragraph 10(g) of the agreement provides that "[e]ach party shall be responsible for its own costs including attorney's fees, in any court, mediation or arbitration proceeding."

of Defendant's claims of fraudulent inducement. Since the parties have not briefed whether New Jersey or Florida law applies to Defendant's fraudulent inducement defense or the merits of that defense, that issue cannot be resolved at this time.

III. CONCLUSION

For the foregoing reasons, DAI's petition to compel arbitration [Doc. #1-1] is DENIED WITHOUT PREJUDICE TO RENEW. DAI's motion for a preliminary injunction [Doc #1-2} is DENIED WITHOUT PREJUDICE TO RENEW. The case shall remain open pending resolution of Defendant's fraudulent inducement defense if and when that defense is addressed by the parties.

SO ORDERED.

Dated at New Haven, Connecticut, May 20, 1997.

Peter C. Dorsey /ss/
Peter C. Dorsey
Chief United States District Judge

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

DOCTOR'S ASSOCIATES, INC.,	:	
Plaintiff,	:	
	:	
-vs-	:	Civil No.
	:	3:97cv00459
ERIK J. HAMILTON,	:	(PCD)
Defendant.	:	

ORDER

Plaintiff Doctor's Associates, Inc. ("DAI") filed a supplemental brief on June 11, 1997. Since DAI's motion to compel arbitration was denied on May 21, 1997, there is no pending motion to supplement. Presumably, that is the reason Defendant did not file a response. DAI's supplemental brief [doc. #22] will be treated as a renewed motion to compel arbitration. DAI's renewed motion to compel is DENIED.

DAI's initial motion to compel arbitration [doc. #1-1] and motion for a preliminary injunction [doc. #1-2] were denied without prejudice to renew because Defendant's fraudulent inducement claim is not subject to arbitration. Doctor's Associates v. Distajo, 66 F.3d 438, 457 (2d Cir. 1995), cert. denied, 116 S. Ct. 1352 (1996). In DAI's supplemental brief, DAI contends that "Mr. Hamilton alleges that he did not understand the plain meaning and effect of the franchise agreement and/or sublease he signed before he became a franchisee." Supplemental Brief, p. 2. Relying on Doctor's Associates, Inc. v. Stuart, 85 F.3d 975 (2d Cir. 1996), and Doctor's Associates, Inc. v.

Distajo, 107 F.3d 126 (2d Cir. 1997), DAI argues that Defendant's fraudulent inducement claim is without merit.

Defendant's state court complaint does not allege fraudulent inducement based on the terms of the franchise agreement, as in Stuart and Distajo.[1] Instead, Defendant alleges that he was fraudulently induced to enter the franchise agreement based on misrepresentations by DAI and DAI's agents regarding the sales and costs associated with the existing franchise that Defendant purchased. See Complaint and Jury Demand, ¶ 10 (attached as Exhibit C to Petition to Compel Arbitration). Accordingly, Stuart and Distajo are not controlling. Since DAI has not addressed Defendant's allegations of fraud, its renewed motion to compel arbitration/ supplemental brief [doc. #22] is DENIED WITHOUT PREJUDICE TO RENEW.

DAI shall have until August 8, 1997, to file a motion addressing the fraud allegations in Defendant's state court complaint, and Defendant shall have 21 days from that date to file a response. In the absence of such filing, this case will be dismissed since the only issue before the Court is whether to compel arbitration.

SO ORDERED.

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[1] In both cases, the franchisees claimed that they were fraudulently induced to enter the franchise agreements by DAI's false representations that arbitration was a condition precedent to either party bringing legal proceedings, while in reality DAI had reserved for itself the right to bring eviction proceedings. See Stuart, 85 F.3d at 979; Distajo, 107 F.3d at 134-35.

Dated at New Haven, Connecticut, July 11, 1997.

Peter C. Dorsey /ss/
Peter C. Dorsey
Chief United States District Judge

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

DOCTOR'S ASSOCIATES, INC., Plaintiff,	:	
-vs-	:	Civil No. 3:97cv00459
ERIK J. HAMILTON, Defendant.	:	(PCD)

ORDER

Plaintiff Doctor's Associates, Inc. ("DAI") moved to compel arbitration and to enjoin Defendant Erik J. Hamilton ("Defendant") from prosecuting an action currently pending in the New Jersey state court. Those motions were denied without prejudice to renew on the basis that Defendant had raised a fraudulent inducement claim that had to be resolved initially by the court.

On August 1, 1997, DAI filed a second supplemental brief in support of renewed petition to compel arbitration. Defendant did not file a response to that brief. DAI correctly pointed out in its supplemental brief that Defendant's allegations of fraud in the inducement relate to the franchise agreement as a whole, rather than the arbitration clause. Accordingly, Defendant's fraud in the inducement claim is one properly resolved by the arbitrator. Campaniello Imports, Ltd. v. Saporiti Italia, 117 F.3d 655, 666 (2d Cir. 1997).

Since the remainder of Defendant's defenses to arbitration were previously rejected in the May 21, 1997 Ruling, that Ruling [doc. #21] denying DAI's petition to compel arbitration [doc. #1-1] and motion for an injunction [doc. #1-2] is hereby VACATED. DAI's renewed petition to compel arbitration [doc. #25] is GRANTED. To effectuate the judgment compelling arbitration, Defendant is enjoined from prosecuting the case pending in the Superior Court of New Jersey, Middlesex County, entitled Erik J. Hamilton, et al. v. Doctor's Associates, Inc., et al., Docket No. L-847-97. No bond will be required in the circumstances in this case. The Clerk shall close the file.

SO ORDERED.

Dated at New Haven, Connecticut, September 18, 1997.

Peter C. Dorsey /ss/
Peter C. Dorsey
Chief United States District Judge